United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

No. 75-6066

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P/S

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION,
Applicant-Appellant,

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,

v.

MORGAN, KENNEDY & CO., INC.;
IRWIN RUDNET AND GERALD RUDNET, Defendants-Appellees.

CLAIM OF READING BODY WORKS, INC.
PROFIT SHARING PLAN TRUST, CLAIMANT-APPELLEE

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF CLAIMANT-APPELLEE READING BODY WORKS, INC.
PROFIT SHARING PLAN TRUST

CHARLES M. SOLOMON
JOHN C. McNAMARA
1401 Walnut Street
Philadelphia, PA 19102
Tel: 215-568-5700

Of Counsel:

FOX, ROTHSCHILD, O'BRIEN & FRANKEL

I N D E X

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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SECURITIES INVESTOR PROTECTION CORPORATION,

Applicant-Appellant,

NO. 75-6066

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

MORGAN, KENNEDY & CO., INC.; IRWIN RUDNET and GERALD RUDNET,

Defendants-Appellees

Claim of Reading Body Works, Inc.
Profit Sharing Plan Trust, Claimant-Appellee

BRIEF OF CLAIMANT-APPELLEE
READING BODY WORKS, INC. PROFIT SHARING PLAN TRUST

Preliminary Statement

This brief is submitted on behalf of the Trustees ("Trustees") of the Reading Body Works, Inc. Profit Sharing Plan Trust ("Trust") in opposition to the appeal of the Securities Investor Protection Corporation ("SIPC") to the United States Court of Appeals for the Second Circuit taken from the Order of District Court Judge Marvin E. Frankel

which affirmed the Order of Bankruptcy Judge Roy Babitt entered in the captioned proceeding that the claim by the Trustees for $133,051.15 be considered the separate claims of the 108 individual beneficiaries of the Trust.

APPELLEE'S STATEMENT OF ISSUE PRESENTED FOR REVIEW

The only question presented in this appeal is whether, under Section 6(c)(2)(A)(ii) [15 U.S.C. § 78 fff(c)(2)(A)(ii)] of the Securities Investor Protection Act (the "1970 Act"), each of the individual beneficiaries of the Plan's Trust account with the Debtor is a separate "customer" and thus entitled to the $20,000 maximum coverage provided for in Section 6(f) of the Act.

This was answered in the affirmative by the Bankruptcy Judge and the District Judge.

NATURE OF CASE, COURSE OF PROCEEDING AND DISPOSITION BELOW

This appeal arises in a proceeding for the liquidation of Morgan, Kennedy & Co., Inc. ("Debtor") under the 1970 Act (15 U.S.C. §§ 78aaa et seq.). Eugene L. Bondy, Jr. ("Bondy") is the trustee for the liquidation of the Debtor.

The three Trustees of the Trust filed a claim for \$133,236.15[1] on behalf of each of the 108 employee-beneficiaries of the Trust (A9-A18). Thereafter, Mr. Bondy filed an application for an order (i) designating the Trustees' claim as the individual claims of the 108 individual beneficiaries of the Trust, and (ii) determining that each of them was a separate "customer" of the Debtor entitled to \$20,000 maximum protection under the 1970 Act (A2-A7). The Trustees joined in Mr. Bondy's application (A22-A23), and SIPC opposed. Bankruptcy Judge Babitt granted Bondy's application (A50-A55) and District Judge Frankel affirmed (A58-A60).

STATEMENT OF FACTS

As the District Court noted (A58) the material facts are undisputed.

In 1957 Reading Body Works, Inc. ("Reading") established the Reading Body Works, Inc. Profit Sharing Plan ("Plan"). Thereafter, Reading and three individual Trustees entered into an Agreement and Declaration of Trust for the benefit of the individual employees of Reading (A3).

1/ Originally this figure was estimated to be \$136,236.15 but was later reduced by \$185. (See Exhibit B to Mr. Bondy's Application.) (A9)

Under the terms of the Plan, the Trust is maintained through yearly contributions by Reading based upon its net earnings. Each employee of the Company accumulates "credits" or a percentage interest in the fund according to his (or her) annual compensation level and consecutive years of service. A separate "account" is maintained for each employee to which is credited his proportionate share of Reading's yearly contribution and any increase in the market value of the Trust fund. Each employee has a non-forfeitable vested interest in the amounts allocated to his account, which is received, according to certain conditions, upon termination of employment with Reading (A3, A50).

The Trust opened an account with the Debtor in December 1972. Following commencement of the liquidation proceedings the Trustees made claim for $133,051.15 which represented a free credit balance in the Trust's account on the date of bankruptcy (A8). The amount and validity of the claim was not in dispute below.

By letter dated October 9, 1973, Mr. Bondy, as trustee for the Debtor, informed SIPC that he intended to treat each of the 108 beneficiaries of the Trust as a separate customer for purposes of the limit to recovery specified in Section 6(f) of the 1970 Act. He therefore requested that SIPC advance the full amount of the claim of the individual beneficiaries of the Trust. Since 107 of 108 beneficiaries had interests of less than $20,000, this would have required

an advance of $132,880.60.

By letters dated May 23, 1974 and June 10, 1974, SIPC's counsel informed the trustee that it would not treat the claim of the Trust as the claim of 108 separate customers of the Debtor but would treat the claim of the Trust as the claim for cash of one "customer" and would therefore only advance a maximum of $20,000.

On September 5, 1974 the trustee made an Application to Bankruptcy Judge Babitt for an order which would designate the claim of the Trustees to be the individual claims of the 108 individual beneficiaries of the Trust; and order that under Section 6(c)(2)(A)(ii) of the 1970 Act each of the individual beneficiaries of the Trust is a separate "customer" and thus entitled to the $20,000 maximum coverage provided in Section 6(f) of the 1970 Act. The trustee's Application was opposed by SIPC and joined in by the Trustees.

In the Memorandum Opinion Bankruptcy Judge Babitt concluded that:

> "... each of the 108 beneficiaries should be considered a separate 'customer' within the meaning of Section 6(f)(1) of SIPA, 15 U.S.C. 78 fff(f)(1)." (A54)

Judge Marvin E. Frankel affirmed the Bankruptcy Judge's Order in an opinion and order dated June 10, 1975.

ARGUMENT

1. Summary

The 1970 Act established SIPC as a non-profit membership corporation for the purpose, inter alia, of providing financial relief to the customers of failing broker-dealers. It created a new form of liquidation proceedings, applicable only to member firms designed to accomplish the completion of open transactions and the speedy return of most customer property.[2]

While the basic framework of the 1970 Act and many of its definitions were derived from section 60e of the Bankruptcy Act, 11 U.S.C. §96e[3], its fundamental change was the "...engraftment of insurance provisions" upon the pre-existing statute. SEC v. Aberdeen Securities, supra, at 1123. This change permitted, inter alia, a customer to "reclaim" cash as well as identifiable securities from an insolvent stockbroker; under the earlier statute a customer

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2/ See S.I.P.C. v. Barbour, U.S. , 95 S. Ct. 1733, 1736 (1975).

3/ See, e.g., SEC v. F.O. Baroff Co., Inc., 497 F.2d 280, 283 (2d Cir. 1974); SEC v. Aberdeen Securities Co., Inc., 480 F.2d 1121 (3d Cir.), cert. denied, 414 U.S. 1111 (1973); SEC v. Kenneth Bove & Co., Inc., 378 F. Supp. 697 (S.D.N.Y. 1974).

was restricted to the reclamation of his identifiable securities. Tepper v. Chichester, 285 F.2d 309 (9th Cir. 1960).

The reclamation procedure is provided by SIPC's advance, pursuant to §6(f)(1), 15 U.S.C. §78 fff(f)(1), of "...such moneys as may be required to pay or otherwise satisfy claims in full of each customer..." within prescribed limits.

It is the definition of "customer" in the 1970 Act and its application to the 108 individual beneficiaries of the Trust that is the issue before this Court. Section 6(c)(2)(A)(ii) defines "customers" as

> "...persons (including persons with whom the debtor deals as principal or agent) who have claims on account of securities received, acquired, or held by the debtor from or for the account of such persons ... with a view to sale, ... and shall include persons who have claims against the debtor arising out of sales or conversions of such securities, and shall include any person who has deposited cash with the debtor for the purpose of purchasing securities..."[4]

4/ Contrary to SIPC's suggestion concerning the meaning of the parenthetical phrase "including persons with whom the debtor deals as principal or agent" at pages 13-14 of its Brief, the phrase was presumably added to avoid the anomalous result in Gordon v. Spalding, 268 F.2d 327 (5th Cir. 1959). There the Court found that the debtor was not a stockbroker within section 60e of the Bankruptcy Act because it had dealt with its customer as "principal" rather than as agent. Cf. In re McMillan, Rapp & Co., 123 F.2d 428 (3d Cir. 1941).

Both Judge Babitt and Judge Frankel apparently conceded that the 1970 Act does not specifically include or exclude the beneficiaries of a trust account as individual customers of a debtor. In addition, neither the express language nor cases interpreting the definition of "customer" in the 1970 Act's predecessor statute, section 60e, proves helpful. However, Judge Babitt concluded that

> "after carefully considering the legislative policy behind the creation of the SIPA ... the purpose of the Act is satisfied by treating each beneficiary of the trust as a separate 'customer' and therefore entitled to the full coverage afforded." (A51).

Judge Frankel agreed with this interpretation. ("It is scarcely an unbearable wrench to include employees for whom the Trust existed as such 'persons'." (A58)).

While several Courts have previously examined the definition of "customer" under the 1970 Act and have even restricted its application to "public customers",[5] "trading" as opposed to lending customers,[6] or "innocent customers",[7] no Court has adopted what SIPC suggests in this Court, viz., to modify the definition of "customer" so that it applies only to an undefined but assertedly "conventional" or "usual"

5/ SEC v. Baroff Company, Inc., 497 F.2d 280, 283 (2d Cir. 1974), SEC v. Alan F. Hughes, Inc., 461 F.2d 974, 977 (2d Cir. 1973).

6/ Baroff, supra, at 284.

7/ SEC v. Packer, Wilbur & Co., Inc., 498 F.2d 978 (2d Cir. 1974).

or "orthodox" or "normal" individual customer of an insolvent broker. Such a proposal as SIPC's would "legislate" the elimination of a stockbroker's "trust customers" as a recognizable class of customers.

While the record is silent on the composition and corresponding percentage of business derived by a stockbroker from SIPC's several classifications of customers, i.e., "conventional", "usual", etc., we urge this Court to conclude that trust accounts are not so "unconventional or bizarre" that their beneficiaries (and real owners) cannot be considered "customers" for the purpose of the 1970 Act. There is no logical or legal justification for such a restriction upon the remedial statute in issue.

While there is an ambiguity in the 1970 Act's definition of "customer" (as well as in its predecessor, section 60e of the Bankruptcy Act) concerning the inclusion of trust beneficiaries within its protective mantle, both the legislative history and the analogy of similar remedial statutes mandate this Court's affirmance of the decisions below.

2. <u>The Statutory Language, Supported By Legislative Intent and Analogous Statutes, Compels the Inclusion of Trust Beneficiaries as Customers.</u>

Each of the 108 beneficiaries of the Trust is a <u>person</u> <u>who</u> <u>has</u> <u>a</u> <u>claim</u> on account of the free credit balance

maintained by the Trust with the Debtor on the date of bankruptcy. This interpretation of the statutory language is reasonable and fair. It is supported by the legislative history to the 1970 Act and the treatment of trusts under comparable statutes. Awarding $132,880.60 to 108 employees will not, as Appellant maintains, undermine the purposes of the 1970 Act. Each of these beneficiaries had a vested and separately ascertainable interest in the corpus of the Trust and, therefore, it can be fairly said that each individual "owns" a portion of the amount owed to the Trust by the Debtor.

The issue presented in this appeal is narrow. It concerns only the extent to which the insurance provisions of the 1970 Act protect the vested interests of beneficiaries of trusts which have established accounts with broker-dealers. The Trustees submit that the vested interests of the beneficiaries of irrevocable trusts are unique and thus entitled to special protection. As will be noted below, trustee accounts are the only accounts which are afforded separate coverage, based upon the number of beneficiaries, under the Federal Deposit Insurance Corporation ("FDIC") Regulations (12 CFR §§330.1(c), 330.10 and 330-Appendix (1974)), and the Federal Savings and Loan Insurance Corporation ("FSLIC") Regulations (12 CFR §§564.2(c), 564.10 and 564-Appendix (1974)).

Congressional Intent Regarding
Insurance Coverage Under the 1970 Act

There is little dispute that the provisions of the 1970 Act are unclear and ambiguous in many respects. SEC v. Aberdeen Securities Co., Inc., 480 F.2d 1121, 1123 (3d Cir.), cert. denied, 414 U.S. 1111 (1973). Both SIPC and the Securities and Exchange Commission have been given authority to formulate rules and regulations regarding the administration of the 1970 Act. (Section 3(b)(3) of the 1970 Act). However, neither has seen fit to enact guidelines for the coverage to be afforded the beneficiaries of trustee accounts, nor to define the term "customer" with regard to coverage of such accounts. In view of this failure to formulate policy, this Court must, as did the Bankruptcy Court and the District Court, look to the intent of Congress. See In re McMillan, Rapp & Co., 38 F. Supp. 40, 41, aff'd. at 123 F.2d 428 (3d Cir. 1941).

Congress, in enacting the 1970 Act, sought to protect the small investor.

> "Today the Securities Subcommittee will begin hearings on legislation, introduced by Senator Muskie, which would create a Federal Broker-Dealer Insurance Corporation.
>
> The need to protect the many millions of Americans who leave their securities with brokers-dealers for safekeeping, who have free credit balances and who must be protected against fails to deliver has intensified over the last several months.

Some of our Nation's largest brokerage firms have reported losses of up to $8.9 million in 1969. The insolvency of any large firm could create havoc in the securities industry due to the interrelationship between broker-dealers.

The real losers would be the small investors, many of whom have invested a significant portion of their savings in securities. It is imperative that these investors be fully protected against brokerage firm failures."[8]

The factory workers and employees of the Reading Body Works are the kind of small investors that Congress sought to protect. The interpretation of "customer" which is put forth in Bankruptcy Judge Babitt's Memorandum Opinion and affirmed by Judge Frankel furthers this intent. Congress also sought to protect the largest possible number of brokerage firm customers rather than the total dollar amounts of money and securities held by firms in safekeeping.[9] This interpretation of the 1970 Act is consistent with extending coverage to the greatest possible number of small investors.

8/ Hearings on S. 2348, S. 2988, S. 2989 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 1 (1970) (the "Senate Hearings").

9/ Hearings on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, H.R. 18458 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong. 2d Sess., 339-340 (1970) (the "House Hearings").

It seems clear that had the Trustees dealt with the Debtor through another broker or bank on behalf of the 108 beneficiaries instead of dealing directly with the Debtor, the individual claims of the beneficiaries would have been paid by now. Section 6(f)(1)(D) of the Act excludes the claims of brokers, dealers or banks unless the claims:

> "... arise out of transactions for customers of such broker or dealer or bank, in which event each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor."

Thus, the Congress did not preclude the examination behind the legal title of a claim to benefit the real parties in interest.

Liquidation and Insurance

An integral aspect of the legislative scheme embodied in the 1970 Act is limited insurance protection for the customers of bankrupt broker-dealers.[10] Congress chose to remedy the problem of loss of public confidence in the securities markets due to the bankruptcy of broker-dealers in drafting an insurance scheme for investors. The scheme is

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10/ Senate Hearings at p. 2; House Hearings at pp. 1, 221-222, 367, 369-70 and 376; Senate Report No. 91-1218, 91st Cong., 2d Sess. 1 (1970).

intentionally similar in almost every material respect to other insurance statutes previously enacted by Congress,[11] except that the insurance was engrafted onto the previously enacted bankruptcy provisions contained in section 60e of the Bankruptcy Act (11 U.S.C. §96e).[12]

Such insurance was without precedent in previous bankruptcy law. The reliance in Appellant's brief on the history and origin of the bankruptcy law as a basis for the interpretation of the word "customer" under the 1970 Act is wholly unjustified. Since section 60e of the Bankruptcy

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11/ Both the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. §§1811, et seq.) and the Federal Savings and Loan Insurance Act ("FSLIA") (12 U.S.C. §§1724, et seq..) provide for the establishment of corporations which are to maintain funds out of which the deposits and accounts of member banks and savings and loan institutions are insured. In both cases the funds are established by member assessments or premiums and in both cases the corporations are authorized to borrow up to specified amounts from the United States Treasury to meet their insurance needs. Both schemes provided limited protection to depositors (now $40,000 per depositor account).

Several courts have acknowledged this similarity: see e.g., SEC v. F.O. Baroff, supra, at 281; SEC v. S.J. Salmon & Co., Inc., 375 F. Supp. 867, 871 (S.D.N.Y. 1974). See also House Report No. 91-1613, Oct. 21, 1970 in U.S. Code Congressional and Administrative News, 91st Cong., 2d Sess 1970, p. 5255.

12/ SEC v. Aberdeen Securities. supra, at 1123.

Act contained no insurance provisions, it is inappropriate (as well as unavailing) to consult the usage of the terms used therein as authority for the insurance aspects of the 1970 Act.

In a section 60e liquidation proceeding, the fact that an account was maintained by a trustee rather than an individual was of no consequence. Each customer was entitled to receive a pro rata share of the single and separate fund based on the dollar amount of the property contained in his account. There was no need to look behind the account to the number of individuals beneficially interested therein. The claim at issue here would have received no greater a distribution whether the trustee under section 60e treated it as a single claim or the claim of 108 persons.

The grafting of insurance provisions onto the liquidation provisions of section 60e of the Bankruptcy Act necessitated for the first time an inquiry into the nature of the entities maintaining broker-dealer accounts. The necessity for such inquiries is clearly evidenced by the promulgation by SIPC of the Series 100 Rules. These Rules were enacted by SIPC in order to determine what accounts held with SIPC members would be deemed accounts of separate customers. There was no need for such a determination under the prior liquidation provisions because there was no insurance coverage.

In formulating the Series 100 Rules SIPC turned to the most logical (and only) available precedent in this regard. An analysis of the Series 100 Rules indicates that in almost every material respect the guidelines adopted therein conform to those adopted by FDIC and FSLIC with regard to the coverage to be afforded deposits and accounts (12 CFR §§330 _et seq_. and 12 CFR §§546 _et seq_.)

FDIA and FSLIA

FDIA and FSLIA provide coverage up to a specified limit (now $40,000) for each insured deposit or account in an insured institution. The regulations promulgated by both FDIC and FSLIC provide that each beneficiary of a trust which maintains an account at an insured institution be given separate coverage and is individually entitled to protection up to the prescribed maximum.[13]

13/ The FDIC regulations provide:

> "Trust accounts. A trust interest is the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, that is valid under State law. Thus, funds deposited in an account by a trustee under an irrevocable express trust are insured on the basis of the beneficial

(Continued on next page.)

13/ (Continued)

interests under such trust. The interest of each beneficiary in an account (or accounts) established under such a trust arrangement is insured up to $15,000, separately from other accounts held by the trustee, the settlor (grantor) or the beneficiary.

* * *

Question: T is a trustee of an irrevocable trust created by S, settlor, for the benefit of A and B in equal shares. T holds an account containing $30,000 in trust funds. A and B, as well as T and S, each maintain individual accounts in the amount of $15,000 each. What is the insurance coverage?

Answer: The trust interests of A and B deposited in the account are each insured to the $15,000 maximum, assuming that neither A nor B have beneficial interests in any other accounts established pursuant to an irrevocable trust created by the same settlor. Since A and B have equal beneficial interests under the trust, each has a proportionate interest in the trust insured. The individual accounts of A, B, T, and S are each separately insured to $15,000 (§330.10)." 12 C.F.R. §330 - Appendix (1974). The FSLIC Regulations appearing at 12 C.F.R. §564 - Appendix (1974) contain a practically identical provision and example.

These regulations were promulgated by FDIC pursuant to a grant of defining authority contained in 12 U.S.C. §1813(m). The purpose of the regulations is to define the term "insured deposit," a term used by FDIA to designate accounts entitled to separate insurance coverage. It seems reasonable that the term "customer" under the 1970 Act should be similarly defined.

The FDIC and FSLIC regulations provide guidelines for the treatment to be accorded deposits and accounts maintained by individuals jointly, by partnerships, by corporations and by executors and administrators of estates (12 CFR §§330 et seq. and 12 CRF §§546 et seq.). In each case the regulations provide that each such deposit or account receive coverage as only one deposit or account. In each case Series 100 Rules provide for the same kind of coverage with respect to each of these enumerated accounts. As noted above, the FDIC and FSLIC regulations provide multiple coverage for the beneficiaries of trust accounts. The Series 100 Rules are silent with respect to multiple coverage of beneficial interests in trust accounts.

The reason for the difference in coverage as between accounts maintained by executors and accounts maintained by Trustees is found in the fact that the interest of the beneficiaries of an irrevocable trust are vested in the beneficiaries whereas the interests of the beneficiaries under a

will do not vest until the estate is closed. The title to the property is still in the executors as executors and not as trustees. See Phair v. Federal Deposit Insurance Corp., 74 F. Supp. 698 (D. N.J. 1947).

The insurance provisions of FDIA, FSLIA and the 1970 Act all have exactly the same purpose. They were enacted to provide limited protection to people who entrust their money or securities to banks, savings and loan institutions and brokers-dealers. In view of this fact and in view of the identical treatment accorded accounts other than trust accounts under all three legislative insurance schemes, there seems no justification for creating an exception under the 1970 Act with respect to the coverage of trust accounts.

Beneficiary Rights Under Section 10(b) of The Securities Exchange Act of 1934

The right of Trust beneficiaries to bring separate causes of action to protect their interests is well established. In James v. Gerber Products Co., 483 F.2d 944, 949 (6th Cir. 1973) the Court held that the beneficiaries of a trust had standing as separate claimants in litigation under Section 10(b) of the Securities Exchange Act of 1934, to which the 1970 Act is to be treated as an amendment (see Section 2 of the 1970 Act). In that case the court stated:

" ... separating the legal and beneficial incidents of ownership in the [trust] property is a mere technical argument since there is only one interest at stake and that is the beneficiary's."[14]

Liability of Broker-Dealers to Trust Beneficiaries Under the Employee Retirement Income Security Act of 1974

Section 502 (29 U.S.C. §1132) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. §1001 *et seq.*) ("ERISA") expressly permits the beneficiaries of an employee benefit plan to sue plan fiduciaries for various kinds of relief. This section of ERISA gives the beneficiaries of plan trusts a wide range of remedies against plan fiduciaries for breach of fiduciary duties. Section 502(a) in part provides:

14/ Accord, Heyman v. Heyman, 356 F. Supp. 958, 965 (S.D. N.Y. 1973) and Local 734 Trust v. Continental Illinois National B&T Co., CCH Fed. Securities Law Reporter, 1973-74 Transfer Binder, ¶94,565 (N.D. Ill. 1974). See also, Section 12(g)(2)(H) of the Securities Exchange Act of 1934 and Section 316(b) of the Trust Indenture Act of 1939 as examples of Congressional concern for the rights of trust beneficiaries.

> "A civil action may be brought --
> (1) by a participant or beneficiary --
>
> * * *
>
> (B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;
>
> * * *
>
> (3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;"

Section 409(a) of ERISA (29 U.S.C. §1109(a)) makes a fiduciary personally liable for losses resulting from any breach of his obligation under the non-tax provisions of the Act.

A fiduciary is defined in §3(21)(A) of ERISA (29 U.S.C. §1002(21)(A)) as anyone who exercises discretionary authority respecting management or disposition of the plan's assets. Thus ERISA expressly gives any beneficiary the right to sue any plan fiduciary who breaches his obligations under ERISA and allows him to recover the losses suffered in his own account. To the extent that a broker-dealer may be deemed a plan fiduciary under ERISA the beneficiary's rights of action would extend against broker-dealers.

This attention to the rights of trust beneficiaries under ERISA is an indication of Congressional concern with the vested rights of employee plan beneficiaries. It is

submitted that Congress also intended that the employees of the company also have the same rights with respect to SIPC coverage.

3. <u>Appellant's Authorities Offer No Support For Its View That Trust Accounts Should Be Treated as Single "Customers" Regardless Of The Number of Beneficial Interests Represented</u>

<u>Financial Burden on SIPC</u>

The possibility of unknown and unlimited liability to SIPC's funds if trust beneficiaries are entitled to separate coverage is not a proper consideration in the determination of the coverage to be given trust interests under the 1970 Act. The insurance provisions of the 1970 Act by their nature subject the SIPC insurance fund to unknown and unlimited liability. The size and frequency of broker-dealer collapses are unpredictable.

Further, there is no factual basis contained in the record herein for this Court to consider the effect, if any, that an affirmance of Judge Babitt's and Judge Frankel's Orders would have on the payments made by SIPC in liquidations conducted by it.

It should be pointed out that the interpretation given the definition of "customer" by the Bankruptcy Court and the District Court does not necessitate an uncontrollable

drain on SIPC's funds. In the only other case dealing with the inclusion of a trust beneficiary within the definition of "customer", In re Weis Securities, Inc., (Claim of McGrath), CCH Fed. Sec. L. Rep. ¶95,061 (S.D.N.Y. March 27, 1975), SIPC funds were preserved by the holding that the trust beneficiary (who was the Executive Vice President of the Debtor), and not the trust, was the "customer". As a result Judge Babitt determined that the individual beneficiary was precluded from protection by the Act's superseding prohibition against advances on claims of a "customer who is a general partner, officer or director of the debtor...", Section 6(f)(1)(C), 15 U.S.C. 78 fff(f)(1)(C). But for this holding the trust of which McGrath was the sole income beneficiary would have been fully reimbursed out of SIPC funds. Such a conclusion would permit the wholesale evasion of Section 6(f)(1)(C)'s limitation through a simple trust device by the very persons whom Congress specifically sought to exclude from coverage.

In addition, it is noted that although the primary purpose of the 1970 Act is to provide protection for investors from their broker's financial troubles, the

> "legislation mandates a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which had

lead to customer loss."[15]

Consequently, SIPC's argument that its payment of the instant and similar claims will unduly deplete its resources ignores its equally-compelling responsibility to avoid the cause of these proceedings, viz., the supervision and elimination of a finacially-irresponsible broker-dealer before bankruptcy.

Appellant's Authorities

Appellant cites several cases (Appellant's brief at pp. 18-19) for the proposition that accounts similar to trustee accounts have been treated in a manner consistent with its view. However, none of these cases concerned accounts maintained by trustees and accordingly none have bearing on the issue at hand.

In SEC v. Horizon Securities, Inc., (Claim of Charon Styx Associates) 72 Civ. 5112 (S.D.N.Y. May 31, 1974, Herzog B.J.) a claim was filed by Charon Styx Associates, a small mutual or hedge fund, against the trustee in the liquidation of Horizon Securities, Inc. The trustee objected to the claim on the ground that Charon Styx Associates was not a "customer" within the meaning of §6(c)(2)(A)(ii) of

15/ House Report No. 91-1613, Oct. 21, 1970 in U.S. Code Congressional and Administrative News, 91st Cong.; 2d Sess. 1970, p. 5255.

the 1970 Act. The Court upheld the trustee's position because the customer's claim had been based upon securities which had not been "received, acquired or held" by the debtor on the "filing date". This case has no bearing on the issues involved in this appeal.

In SIPC v. Dickinson, Rothbart & Co., Inc., 78 Civ. 1105 (S.D.N.Y., February 28, 1975, Herzog B.J.) the Court considered the claim of an investment club filed in a SIPC liquidation of a bankrupt broker-dealer. The Court found that although the investment club had originally entrusted stock to the debtor, the stock was later returned. The Court ruled that the club had suffered no loss and was therefore not entitled to a recovery under SIPA. This case also has no bearing on the issue involved in this appeal.

Finally, Appellant's brief cites and quotes SIPC v. J. Shapiro Co., 473 Civ. 212 (D. Minn., March 18, 1975, Owens B.J.) in support of its claim. This case involved the claim of the executrix of an estate which was based upon an account maintained with a bankrupt broker-dealer. One of the claimant's contentions was that the two beneficiaries under the decedent's will were each entitled to coverage as separate customers. The Court ruled that the executrix's account be deemed a singe "customer" and thus entitled to a maximum coverage of $20,000. This ruling was based upon the fact that Rule 102 of the Series 100 Rules deals specifically with accounts maintained by executors or administrators

and provides that all accounts in the name of a decedent or in the name of the executor of the estate be combined to constitute a single account of a separate customer. This case is not inconsistent with the position that the FDIC and FSLIC analogies be followed in SIPC cases since, as noted above, the regulations promulgated by the FDIC and the FSLIC both provide that accounts maintained by executors and administrators are only entitled to coverage as single accounts regardless of the number of beneficiary interests under the will.

The Legislative History of the 1970 Act.

Not one word of the legislative history cited by Appellant gives any indication that the vested interests of trust beneficiaries should not be given coverage as separate customers under the 1970 Act. Instead SIPC relies upon such unsupported statements as " ... the conventional securities customer was all that anyone had in mind ..."[16] in adopting the 1970 Act. Such statements merely assume the truth of the very propositions they are intended to prove.

16/ Appellant's Brief at page 16.

4. As An Alternative, The Trustees May Be Deemed Customers

In both the Bankruptcy Court and the District Court the trustees presented an alternative basis for recovery, viz., that the three trustees of the Profit Sharing Plan may be considered "customers" within the definition of the 1970 Act, that the cash claims of the three trustees total $59,598.18 and that the security claims of the three trustees total $74,336.25 (Application for Order to Designate Claim of Trustees of Reading Body Works, Inc. Profit Sharing Plan, A22-A25).

While this alternative theory was not ruled upon by Judge Babitt, the trustees present it to this reviewing court as an additional or alternative basis for the recovery.

The question presented for this Court's determination is how the statutory definition of "customers" should be interpreted with respect to trust accounts, where there are multiple trustees and multiple beneficiaries. The key word in the statute is "customers" and not "account".

The three trustees are the persons who opened the account with the Debtor, who were empowered to exercise control of investment decisions and transactions, who communicated regularly with the Debtor, who delivered fully paid securities to the Debtor for the specific purpose of consummating a sale, who instructed it to purchase a U.S. Treasury Bill with the credit balance in the account, and who filed the claim with the Liquidating Trustee.

If the Court is disinclined to affirm the District Court's and Bankruptcy Court's holding that the 108 beneficiaries with vested interests in the Profit Sharing Plan are the customers entitled to be paid by SIPC, then it is respectfully submitted that the three Trustees, who had legal title to the cash and securities and who performed all the above-described acts as customers of Morgan Kennedy, should be the "customers" under the 1970 Act.

SIPC's brief has urged this Court to limit "customers" to the conventional or usual customer of a broker-dealer. The three Trustees, if not the 108 beneficiaries, may be included within such a classification. The Congressional protection runs to "customer" and not to each "account". The three Trustees who performed certain functions on behalf of the beneficiaries in dealing with the Debtor are entitled, as an alternative, to this statutory protection.

If the three Trustees are found to be the "customers", then the statutory limits of $50,000 for a claim of securities or $20,000 for a claim of cash become critical. However, the claim of the three Trustees may be divided into separate claims for cash and for securities. Because the Debtor had entered the proceeds of claimants' sales as credits to claimants' account, both the liquidating trustee and SIPC have asserted that the instant claim is solely for cash.

These entries were substantially false, because while some of the sales of claimants' securities were consummated, most of the claimants' sales were never consummated. The Trustees authorized a series of sales transactions in the final week of the Debtor's existence. The Debtor delivered the certificates to the Chemical Bank for clearing purposes, but Chemical Bank held the claimants' securities instead of delivering them for sale. Claimants pursued other litigation in an attempt to recover from Chemical Bank for this wrongful conversion of their securities.

The credits entered in the claimants' account by the insolvent Debtor are therefore fictitious to the extent that the sales were never consummated. The claimants filed their proof of claim with the Liquidating Trustee in the alternative for both cash in the full amount of the free credit balance for $133,051.15 and for the securities that were never delivered for sale.

As claimants now know the facts, their claim is a cash claim for the unpaid proceeds of completed sales as follows:

100 shares Syntex Corporation	$8,234.83
200 shares Commercial Bankcorporation of Colorado	1,363.35
U.S. Treasury Bill	50,000.00
Total cash claim	$59,598.18

As claimants now know the facts, their claim for securities in excess of the above itemized cash claim is for securities that were not sold pursuant to claimants' order:

300 shares Commercial Bankcorporation of Colorado	$ 2,100.00
300 shares Anaconda Co.	6,450.00
100 shares Itek Corp.	4,400.00
900 shares Pacific T&T Corp.	16,087.50
400 shares $4.00 conv. pfd. A.T.&T.	24,350.00
$10,000 Debenture, 7%, 2001, A.T.&T.	9 666.25
Interest thereon	11.67
$10,000 Debenture, 8.75%, 2000, A.T.&T.	11,037.50
Interest thereon	233.33
Total securities claim	$74,336.25

The total of these separate claims is $133,935.43 which differs from the original claim of $133,051.00 by the amount of commissions on the unsold securities.

CONCLUSION

Congress could have specifically provided that trust accounts be covered as single customers. It did not. On the contrary the definition of "customer" contained in Section 6(c)(2)(A)(ii) of the 1970 Act defines customers as persons having claims on account of securities. There is no specific requirement that such persons maintain individual

accounts. Congress intended to follow the provisions of FDIA and FSLIA in drafting the insurance provisions of SIPA. In every material respect the coverage afforded to other types of customer accounts is identical to the coverage provided for in the FDIC and FSLIC Regulations. Given the long standing practice of giving separate coverage to trust interests under these two other insurance schemes, Congress must have intended to adopt a similar scheme of coverage for trust interests.

Therefore, it is respectfully requested that this Court uphold the Order of District Judge Frankel which affirmed the Order of Bankruptcy Judge Babitt that the claim of the Reading Trustees be deemed the separate claims of the 108 individual beneficiaries of the trust; in the alternative, it is requested that the three Trustees be deemed the three customers who are entitled to payment of their cash claims and securities claims.

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Respectfully submitted,

FOX, ROTHSCHILD, O'BRIEN & FRANKEL

By: Charles M. Solomon

CHARLES M. SOLOMON
JOHN C. McNAMARA
Attorneys for the Trustees of the Reading Body Works, Inc. Profit Sharing Plan Trust
1401 Walnut Street, 10th Floor
Philadelphia, PA 19102
(215) LO 8-5700

CERTIFICATE OF SERVICE

I hereby certify that on this 2nd day of October, 1975, I served the attached Brief of the Trustees of Reading Body Works Inc., Profit Sharing Plan Trust upon the following persons by depositing five copies thereof in the United States mails, post paid, addressed to them as indicated below:

ROBERTA S. KARMEL, Esq.
Rogers & Wells
200 Park Avenue
New York, New York 10017

MICHAEL E. DON, Esq.
SECURITIES INVESTOR PROTECTION CORPORATION
900 Seventeenth Street, N.W.
Suite 800
Washington, D.C. 20006

Charles M. Solomon

Charles M. Solomon